THE CIVIL WAR INCOME TAX.

I.

The Civil War gave birth to many innovations in our financial legislation. Some outlived the war period, and are still thriving in these days of peace: others have disappeared, — it may be forever, but we must not speak too confidently. There were measures which the boldest innovator would hardly have dared propose in time of peace; but under the stress of war they were enacted, sometimes with little opposition and little discussion. And now, after thirty years of peace, there is hardly a feature of this war legislation, from a national banking system to an inflated currency, which will not find earnest support and advocacy among some class of people. The income tax was the first of these innovations to be adopted, and was among the first to disappear. Will it also be the first to be restored? This at the present time is a question of living interest.

The tax was introduced in the act of August 5, 1861. There had been no precedent for such a form of taxation in our history even in time of war. An income tax had, indeed, been suggested during the War of 1812 (Special Report of Secretary Dallas, January 17, 1815), but not seriously considered. Such taxes, however, were familiar enough in England and other European countries; and it is not strange that Congress should have thought of taxing incomes at a period when its policy was to tax everything taxable. It is, however, a little remarkable that the tax should have been introduced so early as 1861; for the act of that year was, on the whole, a very moderate and conservative revenue measure, enacted before the country had any idea how serious and protracted the struggle and how heavy the financial burdens of the war would prove to be. A brief study of the legislative history of the measure will enable us to understand how it came to include such a novelty as the income tax.

Congress was convened in extraordinary session on July 4, 1861. Secretary Chase, in his report on the finances, outlined

the financial legislation which he thought the exigencies of the situation demanded; but he made no reference to an income tax. He expressed the opinion that $240,000,000 should be raised by loans and $80,000,000 by means of taxation. The existing tariff, he thought, would yield about $30,000,000, leaving $50,000,000 to be secured by new taxes or other revenue. $27,000,000 could be obtained by increasing the duty on sugar, imposing duties on tea and coffee, and making some other changes in the tariff. $3,000,000 might be expected from sales of public lands. The remaining $20,000,000 he proposed to raise "by direct taxes or from internal duties or excises or both." He even intimated a hope that this taxation would not have to be imposed after the current year.

The policy thus outlined in his report relied principally on loans as a means of raising money, and proposed a very moderate, cautious, and, as the event showed, wholly inadequate resort to taxation. It is not surprising, then, that he did not suggest anything so radical as an income tax; for, when he spoke of "direct taxes," he had in mind those forms of taxation which this term, as used in the Constitution, would include,— namely, capitation taxes, taxes on real estate, and "probably," he adds, "general taxes on personal property." As to the income tax, the Supreme Court has since then decided that it is not a direct tax in the meaning of the Constitution.*

The House Committee of Ways and Means followed out the recommendations of the Secretary. They prepared two bills, one of which dealt with the proposed tariff changes, imposing duties on tea, coffee, and sugar. The other was the internal revenue measure. It imposed license taxes and taxes on whiskey, beer, porter, carriages, promissory notes, and bank bills. It also contained a provision for a direct tax of $30,000,000. This, as the Constitution required, was to be apportioned among the States on the basis of population. The quotas of the loyal States, in which alone the tax could be

* *Springer* v. *United States*, 102 U. S 508. The decision was that direct taxes within the meaning of the Constitution are only capitation taxes as expressed in that instrument and taxes on real estate. See article on "The Direct Tax of 1861" in the *Quarterly Journal of Economics*, July, 1889

made immediately operative, amounted to $20,000,000. This was a form of taxation of which the country had already had experience. This bill, indeed, was said to be an exact copy of one framed by Albert Gallatin.

When, however, the bill came before the House, it was not received with much favor. One objection urged against it was that it created an army of office-holders for the collection of these taxes; and an effort was made to have the taxes collected by State machinery. But the Committee of Ways and Means reported that they could devise no constitutional means for doing this. To many, however, the most objectionable feature of the bill was the direct tax itself. This was opposed, first, because it did not rest on personal property as well as on real estate. It was true that the States were at liberty to assume their respective quotas; and in that case the tax, being assessed and collected under State laws, would probably be imposed on personal property as well as real estate. But Congress could not take it for granted that the States would all assume the tax; and, where they did not, it was to be collected by federal machinery and assessed on real estate.

A second and more serious objection to the tax was its apportionment among the States on the basis of population, as required by the Constitution. The distribution of population was far from corresponding to that of wealth. The disparity was much greater in 1861 than it had been in 1816, when the last direct tax had been assessed. There had been a concentration of wealth and capital in the Eastern States, a rapid growth of population in the Western. Hence the representatives from the West were especially active in opposing the direct tax.*

But, if the direct tax was to be rejected, some substitute for it must be found; and many members began to express a preference for an income tax. The principal argument which the Committee of Ways and Means urged against making any such change was the need of prompt action. But this did not

*In the course of the debate statistics were presented to show the inequalities in the assessment which would result from this method of apportionment The quota of Illinois, for instance, would, it was urged, require a tax of nearly 6 per cent. on the valuation of real estate, while in Massachusetts the rate would be only 2 6 per cent.

seem to the House a sufficient reason for accepting the bill as it stood. "There is no stress of weather," said Mr. Colfax, "which can induce me to vote for the bill as it now stands. I cannot go home, and tell my constituents that I voted for a bill that would allow a man, a millionaire, who has put his entire property into stock, to be exempt from taxation, while a farmer who lives by his side must pay a tax." So the committee, acting on a vote of instruction passed by the House, revised the bill so as to reduce the direct tax from $30,000,000 to $20,000,000, and impose an income tax of 3 per cent. on all income over $600. The bill in this form was accepted by the House, and passed at once.*

In the mean time an income tax had also been proposed in the Senate. There the question came up in connection with the tariff bill, which had passed the House, July 18. In the Senate the Committee of Finance, to whom this bill had been referred, reported it with a substitute which aimed to make the tariff duties more productive of revenue. Mr. Simmons, chairman of the committee, thought that, in addition to this revenue from the tariff, $20,000,000 should be raised by a tax on incomes. He therefore offered an amendment, which the Senate readily accepted, imposing a tax of 5 per cent. on income over $1,000. There was but little discussion; but it is evident from what was said that the Senate hoped by this action to be able to dispense with the direct tax which had been proposed in the House, the majority of senators preferring an income tax to a property tax which must be apportioned on the basis of population.† The amendment was adopted on the same day that the House passed the internal revenue bill containing the income tax section.

The form which these measures finally assumed in the act of August 5 was, as usual, determined by the Committee of Conference appointed by the two branches of Congress. The direct tax of $20,000,000 proposed by the House was retained; and, as for the income tax, the 3 per cent. rate was adopted with an exemption of $800.

*July 29, 1861, *Congressional Globe*, p 331.

† Remarks of Mr. Fessenden, *Congressional Globe*, p. 255, and of Mr Simmons, p. 313.

Thus it appears to have been opposition to the direct tax which led to the adoption of an income tax at this particular time. This is not saying that it might not have been adopted later, even if the Constitution had not required the apportionment of direct taxes on the basis of population. As it was, however, this requirement proved to be a serious objection to the taxes on real estate or other property; and the income tax was about the only other way of levying directly a tax on the wealth or financial resources of each citizen.

The act of 1861 may be said to have committed the country to the policy of taxing incomes; but no income tax was in fact assessed under that law. According to the terms of the act the tax was to be assessed on the income of 1861, and was payable on or before the 30th of June, 1862. But this legislation was regarded as essentially provisional. Congress was to meet again in December, seven months before any revenue from the income tax could be received. It was to be expected that at this next session the act would be reconsidered, and perhaps undergo important modifications; and the Secretary of the Treasury, therefore, took no steps for the enforcement of the income tax, but awaited the further action of Congress. In his annual report he commended the "prudent forecast which induced Congress to postpone to another year the necessity of taking steps for the practical enforcement of the law," thus affording "happily the opportunity of revision and modification." He doubted the advisability of enforcing the income tax at all.

> The Secretary is acquainted with no statistics which afford the means of a satisfactory estimate of the amount likely to be realized from the income tax. Considering, however, how large a proportion of incomes after the deductions sanctioned by law will fall within the exemption limit of $800 a year, and considering also what numerous questions will certainly perplex its assessment and collection, he respectfully submits whether the probable revenue affords a sufficient reason for putting in operation, at great cost, the machinery of the act, with a view, should the States assume the direct tax, to the collection of the income tax alone.

The Secretary favored an increase of the direct tax to the sum originally proposed,— namely, $30,000,000,— and proposed

to raise $50,000,000 by internal taxation and without resorting to an income tax. He was aware, he said, that the sum was large; but he felt that he "must not shrink from a plain statement of the actual necessities of the situation."

This report was presented on the 9th of December, 1861. On March 12, 1862, the Committee of Ways and Means reported an internal revenue bill which, it was estimated, would produce $164,000,000 annually, or more than three times the amount which the Secretary had apologetically asked for. The country was beginning to realize what the war meant. The bill imposed a tax of 3 per cent. on incomes above $600, from which the committee expected to obtain $5,000,000 of the above revenue. Mr. Morrill, in reporting the measure, said: —

> The income duty is one perhaps of the least defensible that, on the whole, the Committee of Ways and Means concluded to retain or report. The objection to it is that nearly all persons will have been already once taxed upon the sources from which this income is derived. There are few persons in the country who have any fixed incomes for a term of years. The income tax is an inquisitorial one at best; but upon looking at the considerable class of State officers, and the many thousands who are employed on a fixed salary, many of whom would not contribute a penny unless called upon through this tax, it has been thought best not to wholly abandon it. Ought not men, too, with large incomes to pay more in proportion to what they have than those with limited means who live by the work of their hands or that of their families? *

But, if Mr. Morrill anticipated any considerable opposition to the tax, he was happily disappointed. No strong objection seems to have been made to it in any quarter. Congress had made up its mind that the proposed revenue must be raised. The income tax was but one item, and by no means the most important one, among the large number which made up this extensive and complicated revenue measure. If there were members who, like Mr. Morrill, regarded it as the least defensible of the taxes proposed, no one seemed to think it worth while to move to strike it out or was ready to suggest anything else in its place. In fact, notwithstanding the number of times the income tax was subsequently re-enacted or

* *Congressional Globe*, 39th Congress, 2d Session, p. 1196.

amended, the main question whether there should be such a tax at all was not seriously considered again until 1870. Up to that year the country seemed perfectly willing to accept this form of taxation as a part of the burden necessitated by the war.

II.

Until 1870, then, the questions discussed were mainly those of detail; and prominent among them was the question of the rate to be levied. The bill of March, 1862, retained the uniform 3 per cent. rate which had been adopted in the act of 1861. In the House no change was proposed. The higher rates of the act of 1862 originated in the Senate. There Mr. Fessenden, chairman of the Committee of Finance, moved an amendment retaining the 3 per cent. rate for incomes not over $10,000, and making the rate 5 per cent. if the income exceeded $10,000, and 7½ per cent. if it exceeded $50,000. These rates were to be assessed on the excess of income over $600. Mr. Chandler, of Michigan, made some objections to the proposed change; but no one supported him, and the amendment was adopted without much debate.

The Senate had voted to strike out the direct tax which was a feature of the House bill, and it is not improbable that the above amendment was adopted with a view to supplying the revenue which the direct tax would have yielded. The House was strongly in favor of the latter tax. This disagreement between the two branches of Congress, which threatened to prove disastrous to the bill, was finally settled in the Committee of Conference. The direct tax was not struck out, but its assessment was suspended for two years; and this suspension proved to be final, for two years later the tax was repealed. It had been driven from the field by its rival, the income tax. As for the progressive features introduced in the income tax by the Senate, they probably do not indicate any disposition to favor the principle of progression for its own sake, but resulted almost inevitably from increasing the rates. To impose a tax of 7½ per cent. on all income above $600 would probably have been regarded as an excessive and unjust

burden on the smaller incomes. Either the limit of exemption must be raised or lower rates must be adopted at first, and the higher rate applied only after the income mounted to a higher figure.

The Committee of Conference modified the Senate amendment by striking out the 7½ per cent. rate for income over $50,000. It retained the 5 per cent. rate for income above $10,000, and the 3 per cent. rate below that point. Under this act, which was signed July 1, 1862, the income tax first went into operation. The income tax sections of the act of 1861 had never been enforced, and were now repealed.

The next revision of the income tax took place in 1864, forming a part of the act of June 30. This act was the most important revenue measure of the war, and was expected to produce a revenue of about $250,000,000. In its main features, however, it followed the act of 1862, but with modifications in detail and a general increase in rates. As for the income tax, the bill as introduced by the Committee of Ways and Means did away with the differential rates, and proposed to assess a tax of 5 per cent. on all incomes, with an exemption, as before, of $600. But the House voted to make the rate 7½ per cent. on income over $10,000, and 10 per cent. on that over $25,000. There was a good deal of discussion before the vote was taken. Many members were opposed to the progressive principle. They condemned it as being virtually "a confiscation of property because one man happens to have a little more than another," * as punishing men because they are rich, and the like.† The defenders of progression claimed that it was justifiable on the same principle as a tax on luxuries, that it was simply a means of making the rich contribute their due proportion to the expenses of the war, offsetting the disproportionate share of indirect taxes paid by the lower and middle classes.

The question was again discussed in the Senate, where the Committee of Finance proposed to strike out the 10 per cent. rate on income over $25,000. Mr. Sumner thought this would

* Remarks of Mr. Morrill, *Congressional Globe*, p 1876.

† Remarks of Mr. Stevens, *Ibid.*

be a departure from correct principles, and cited Adam Smith and Say in support of progressive taxation. The Senate at first accepted the proposed change. Later, however, it voted to restore the 10 per cent. rate, apply it to income over $10,000, and at the same time apply the 7½ per cent. rate to income between $5,000 and $10,000. One of the senators wanted to know on what principle a larger tax was imposed on an increased income. Mr. Grimes, of Iowa, replied: "As to the practice, we have already established that by a very decisive vote. As to the principle on which it is based, I will refer the senator from Missouri [Mr. Henderson] to the senator from Massachusetts [Mr. Sumner] and the array of authorities which he read to us the other day from Say and other political economists, showing us that this was the principle on which all income taxes ought to be assessed; and it is not for me to controvert the authorities which the senator from Massachusetts exhibited here to so great an extent, and it seems to me that they have made such an impression on the minds of the senators that we have reversed the decision made at that time, and decided exactly the contrary to-day." *

The tone of these remarks would lead us to question the senator's sincerity in suggesting this explanation of the Senate's reversal of its previous decision. It is to be noted that, in the interval between the first vote on this question and the second, Mr. Grimes had moved to postpone indefinitely the direct tax, which, according to the House bill, was to be assessed in 1865; and this motion was carried. The list of senators who voted in the affirmative corresponds pretty closely to the list of those who afterwards voted for the higher rates on incomes.† Apparently, a group of senators, mainly from the Western States, made up their minds that the

* *Congressional Globe*, 1st Session, 38th Congress, p. 2760.

† Of the twenty-one who had voted against the direct tax, only four — Henderson, of Missouri, Howe, of Wisconsin, Powell, of Kentucky, and Richardson, of Illinois — voted against the higher income-tax rates Of the sixteen who had voted in favor of the direct tax, only five — Conness, of California, Harris and Morgan, of New York, Sumner, of Massachusetts, and Ten Eyck, of New Jersey — voted in favor of the higher rates. Of these five, all but one had voted against the higher rates on the first vote taken before the vote which struck out the direct tax.

direct tax must go; and, that tax being disposed of, the Senate, in order to make good the revenue, consented to increase the income tax.

When the bill assumed its final form in the Committee of Conference, the income tax was changed so as to make the 10 per cent. rate begin at $10,000,— a lower point than either House or Senate had selected. This seems a singular step to be taken by a committee which is expected to compromise the differences between the two branches of Congress; but it excited no protest.

Before the income tax sections of the act of 1864 went into operation, they were amended by the act of March 3, 1865. Under this act the rates reached the highest point in the history of the tax. The 7½ per cent. rate was abolished, and the 10 per cent. rate was applied to all income over $5,000, the rate below that point being, as before, 5 per cent. This change aroused very little debate in either branch of Congress.

By 1866 the finances of the government were in a condition to allow some reduction of taxation; and a bill was introduced which was expected to secure relief to the extent of $75,000,000. As regards the income tax, it was proposed to return to a uniform rate, 5 per cent., and raise the exemption to $1,000. "In a republican form of government," said Mr. Morrill, in introducing the bill, "the true theory is to make no distinctions as to persons in the rate of taxation." But the House, after some debate, voted to continue the 10 per cent. rate on income over $5,000. The Senate, however, favored postponing action on the income tax until the next session, which would open before the proposed changes could go into operation. The House agreed to this, and the matter went over. In the next session the House voted against a 10 per cent. rate by a majority as strong as that which had favored it in the previous session. The Senate made no effort to continue the higher rate; and thus the act of March 2, 1867, introduced a uniform 5 per cent. rate with an exemption of $1,000. No further changes were made in the income tax until 1870.

In the early history of the tax there were some other dis-

tinctions in the rates besides those based on the amount of the income. One of these was in regard to income consisting of interest on United States securities. The policy at first was to tax it at a lower rate. The object was to encourage loans to the government. The Senate introduced this feature in the act of 1861, under which interest on such securities was to be taxed 1½ instead of 3 per cent. The act of 1862 observed the same distinction, taxing interest on bonds at 2½ per cent., while the rates for other forms of income were 3 and 5 per cent. The act of 1864 did away with this distinction; and thereafter the interest on government securities was subject to the same tax as other forms of income.

Another distinction observed in this earlier period was in regard to the income from property in the United States owned by citizens residing abroad. This was taxed at a higher rate with the idea, apparently, that these citizens by spending their incomes in a foreign country were evading the taxes on consumption which our laws imposed. Under the act of 1861 such income was to be taxed 5 per cent. The act of 1862 retained the five per cent. rate, which, however, was a discrimination against this class of citizens only when their incomes were under $10,000, since citizens at home were likewise taxed 5 per cent. on income above that amount. This distinction was also discontinued under the act of 1864.

In addition to the regular income tax a special tax was assessed on the income of 1863 by a joint resolution of Congress passed July 4, 1864, in order to provide for the bounties required under the recent enrolment act. The rate was 5 per cent. on all income over $600. This made the total tax assessed in the end, on the income of 1863, 8 per cent. on income between $600 and $10,000 and 10 per cent. on income over $10,000. The special tax was assessed Oct. 1, 1864.

III.

The legislation we have been considering made express provision for the taxation of certain classes of dividends and interest payments. The act of 1862 imposed a tax of 3 per cent. on the interest or dividends paid by railroad corpora-

tions, and a like tax on the dividends of all banks, trust companies, savings institutions, or insurance companies, and on all sums added to their surplus or contingent funds. This tax was to be deducted from the interest or dividends, and paid over to the tax collector by the officers of the company or corporation. Dividends and interest thus assessed were not subject to further taxation as income. This tax, therefore, was essentially a part of the income tax, and was so regarded, being in effect an assessment on the income of the stockholder or bondholder, who received his interest or dividends diminished by the amount of the tax. Theoretically, it was the same thing in the end as if the tax had been assessed directly on his income and collected from him; but, in practice, it was much easier and simpler to collect from the corporations than from the individual stockholders and bondholders, and therefore Congress availed itself of the well-recognized advantages of taxing income at its source.* At the same time certain inconsistencies resulted from adopting this course.

For, in the first place, the personal income tax, as we have seen, imposed a higher rate on the larger incomes; but this distinction could not well be observed in taxing dividends and interest. Yet there was a certain degree of injustice in not observing it. Under the act of 1862 the result was that, while an income of over $10,000 derived, say, from some private business, from professional fees, or a salary, was taxed 5 per cent., an income of the same amount, consisting of interest and dividends received from railroads or banks, was taxed only 3 per cent. By the act of 1864 the tax on interest and dividends was raised to 5 per cent., thus corresponding again to the lowest rate assessed on personal incomes; but, as 10 per

* We do not mean to imply, however, that this tax was in the first instance resorted to with the idea of securing a more efficient assessment of this form of income. On the contrary, the indications are that at first this tax was imposed simply because the interest and dividends of railroads and banks were regarded as convenient objects of taxation, but, to avoid double taxation, it was found necessary to exempt them from the personal income tax. Later these two taxes came to be regarded as two subdivisions of a general income tax. Thus in the act of 1862 the provisions as to interest and dividends are given under a separate title, and precede those in regard to personal income, but in the act of 1864 the order is reversed, and all these sections form one group under the general title of "Income."

cent. was now assessed on personal income in excess of $5,000, the disparity between the two methods of taxation was as marked as before. It did not cease until under the act of 1867 a uniform rate was adopted for all forms of income of whatever amount.

It was also considered impracticable, as regards the taxation of interest and dividends, to apply the principle of exempting a certain amount. The tax-payer whose income consisted entirely of interest and dividends was thereby deprived of a form of relief which other tax-payers enjoyed. This inconsistency did not escape the notice of Congress. There were members who were fond of denouncing a system which operated injuriously upon "a class of persons composed almost exclusively of widows and orphans"; and propositions were made to have the tax refunded to those receiving the interest and dividends, if their total income did not exceed the amount exempted from the personal income tax. But such proposals, although admitted to be just in principle, were rejected as impracticable.*

The method of taxing at the source was also applied to the salaries paid by the government,—that is, the tax was simply deducted from salaries as they were paid; and, as in the case of interest and dividends, the rate was uniform, corresponding to the lowest rate on other forms of income. Such salaries, therefore, were taxed at 3 per cent. until the act of 1864 went in force, and after that at 5 per cent. It is not apparent why there should have been any difficulty in introducing gradations in the rates in this case. But it was practically a matter of no great importance, as very few salaries paid by the government in those days exceeded $5,000. A rather tardy attempt was made to remove this defect in the law in 1866, when, on motion of Mr. Garfield, an amendment was passed, making the rate 10 per cent. when the salary exceeded $5,000; but before the time came for the enforcement of this provision, the act of 1867 was passed, which, as already stated, introduced the uniform 5 per cent. rate for all forms of income.

* See *Congressional Globe*, 1st Session, 39th Congress, p. 2786, 2d Session, 41st Congress, p. 5103.

IV.

In the administration of an income tax embarrassing questions sometimes present themselves in regard to the correct conception or definition of income. By the act of 1861 the income to be taxed was defined, in general terms, as that "derived from any kind of property, or from any profession, trade, employment, or vocation carried on in the United States or elsewhere, or from any other source whatever." This definition seems pretty inclusive, but would probably not have been of much practical assistance in the administration of the tax. But the act was not intended to be very explicit, being framed with the idea of leaving matters of detail to be settled by rulings of the Treasury Department.*

The act of 1862 amplified this definition somewhat without greatly improving it. The tax was to be levied upon "the annual gains, profits, or income of every person residing in the United States, whether derived from any kind of property, rents, interest, dividends, salaries, or from any profession, trade, employment, or vocation carried on in the United States or elsewhere, or from any other source whatever except as hereinafter mentioned." † The last words evidently refer to certain deductions which the act permitted. Thus we find that "all other national, state, and local taxes lawfully assessed upon the property, or other sources of income," were to be deducted; and, also, all salaries and payments from the United States, and those dividends and interest payments which, as we have seen, were taxed by a distinct method. Of course, these last deductions were allowed simply to guard against double taxation; and this was apparently the object of the provision — found only in this act — that "the income derived from advertisements, or from any article manufactured upon which specific, stamp, or *ad valorem* duties shall have been directly assessed or paid, shall be deducted." ‡

*"This bill provides that all the details, the mode of assessing the tax, what shall be assessed and what shall be deducted, shall be prescribed by the Secretary of the Treasury." Speech of Mr. Simmons, *Congressional Globe*, 1st Session, 37th Congress, p 315

† Act of July 1, 1862, section 90.

‡ The clause would seem to cover pretty much all income derived from manufacturing, for the articles manufactured and not taxed in those days were few

The legislation of 1864 and subsequent years was more explicit as to what should be included and what deducted in estimating taxable income. We find that the income was to include the following items: —

1. "Interest received or accrued upon all notes, bonds, mortgages, or other forms of indebtedness bearing interest, whether paid or not, if good and collectible, less the interest which has become due [from the tax-payer] during the year." *

2. "Profits realized from sales of real estate purchased within the year or within two years previous to the year for which the income is estimated." † There is some difficulty in deciding how to deal with these profits on real estate transactions. Evidently, they are a form of income; but should they always be included in the income of the year in which the real estate is sold? Under the act of 1862, which was silent on this point, the Commissioner of Internal Revenue ruled that, whenever a man sold an estate for more than he paid for it, the difference must be included in the income for the year in which the sale took place, no matter how long the estate had been in his possession. The act of 1804 provided that such profits should be included only when the real estate had been purchased within the year for which the income was estimated; but in the act of 1867, from which we have quoted, the rule was extended so as to cover purchases within the two years previous. The limit selected seems to be wholly arbitrary, and perhaps it could not well be otherwise. But why should the profits from the sale of an estate which has been held three years and a day be exempt from the tax, while, if the estate had been sold two days sooner, they would have been taxable? This inconsistency in the law did not escape the notice of those who in 1870 were urging every possible argument against the income tax.‡ According to the act of

and far between If the intention was to avoid double taxation, the assumption must have been that a tax on manufactures rested on producers rather than consumers. This provision, however, never had to be enforced, for it was omitted in the amendatory act of March 3, 1863 The provision in reference to advertisements, however, remained law until the act of 1864 was passed

*Act of March 2, 1867, section 13 In substance, the same provision was contained in the act of 1864, section 117.

† Act of 1867, section 13

‡ *Congressional Globe*, 2d session, 41st Congress, p 4717.

1864 the taxable income was also to include "all income or gains derived from the purchase and sale of stocks or other property, real or personal," to which the act of 1865 added the words "or live stock"; but this provision was not retained in the act of 1867.

3. The income was to include "the amount of sales of live stock, sugar, wool, butter, cheese, pork, beef, mutton, or other meats, hay and grain, fruits, vegetables, or other productions, being the growth or produce of the estate of [the tax-payer], but not including any portion thereof consumed directly by the family."* It is not clear why the amount of these products consumed by the family should have been exempted. There seems to be no better reason for it, in principle, than there would be for allowing the receiver of a salary to deduct the amount paid for his board.

As regards this method of estimating agricultural income, the criticism of the Commissioner of Internal Revenue, Mr. J. J. Lewis, is of interest: "The best test of the yearly income from real estate is its rental value. A rule requiring such income to be assessed on that value would be conveniently practicable, and would obviate the necessity of the vexatious inquisition now required in ascertaining the comparative value of live stock at different periods and the amount of butter, beef, cheese, etc., sold or on hand. Such estimates must needs be very unequal, and the returns incomplete."†

4. The income was to include "the share of any person of the gains or profits, whether divided or not, of all companies or partnerships, but not including the amount received from any corporations whose officers, as authorized by law, withhold and pay as taxes a per centum of the dividends made, and of interest or coupons paid by such corporations."‡

*The language quoted is that of the act of 1870, but substantially the same provision was introduced in the act of 1864. It underwent verbal changes in every subsequent act until it finally took the form given above. Originally, the enumeration even included "the increased value of live stock, whether sold or on hand," so that not even the year's growth of a calf was to be ignored in estimating the farmer's income.

† *Internal Revenue Reports*, 1864, House Executive Documents, 1864–65, vol. VII.

‡ Act of 1870, section 7. But essentially the same provision is found in all previous acts as far back as 1864.

5. Finally, the income was to include "all other gains, profits, and income drawn from any source whatever, except the rental value of the homestead."* This brings us to the deductions and exemptions provided for in these acts.

First there was the exemption of a minimum, which is a feature of nearly all income tax legislation, for reasons too well known to be repeated here. Under the acts of 1862, 1864, and 1865, the amount exempted was $600, which after the inflation of the currency represented but a trifling income. In 1867 the amount was raised to $1,000, and in 1870 to $2,000. The tax was assessed on the amount by which any income exceeded the limit of exemption, and only one such deduction could be made from the aggregate income of all the members of any family consisting of parents and minor children or of husband and wife.

The amount actually paid for the rent of the dwelling-house or estate on which the tax-payer resides was also to be deducted. This provision first appeared in the amendatory act of March 3, 1863. It is not clear why a man should be allowed to deduct the amount paid for the rent of his dwelling any more than the amount paid for clothing. The rule was introduced on the assumption that the term "income" did not include the rental value of a house occupied by the owner,—a point on which the law, however, was silent at that time. The amendment exempting the rent paid for a dwelling was accordingly proposed for the avowed purpose of placing the man who hired a dwelling on the same footing with the man who owned one. The latter, it was said, "does not pay any rent, nor does he account for the rent of his house in his income; and the person who hires and occupies a house should be on the same footing." That seemed reasonable, and the amendment was accordingly adopted. But these two men might just as well have been put on the same footing by requiring the one who owned his dwelling to include its rental value in his income, and not allowing the one who hired a dwelling to deduct the rent paid for it. Later, under the act of 1864, express provision was made for the case of a man

* Act of 1867, section 13.

owning his dwelling, by explicitly excluding its rental value from his income. This time it may fairly have been thought necessary to put the man who owned his dwelling on the same footing with the man who hired one. The act accordingly provided that "the amount paid by any person for the rent of the homestead used or occupied by himself or his family, and the rental value of any homestead used or occupied by any person or by his family, in his own right or in the right of his wife, shall not be included and assessed as a part of his income."* This clause was an amendment introduced by the Senate Committee of Finance. The bill as it came from the House had exempted $200 of rental value, and allowed a deduction of $200 for rent. Mr. Fessenden, chairman of the Senate Committee, said that the House proposal could not be carried out "without making a very odious discrimination between town and country. . . . It would impose a burden upon certain men who happened to live in the city from which men living in the country where rents are low, comparatively nothing, would be exempt." A similar proposal was made by the House in 1870, but was again rejected by the Senate.

The policy which the House attempted to introduce was advocated by Commissioner Lewis in his annual report for 1864: "I am unable to see why the man who consumes his income should not be taxed for it as well as the man who saves it; nor why the one who lives in his own house should not be taxed on its rental value as much as if he let it to another, and put the rent in his own purse. If it be deemed right to allow the occupant of his own homestead such a portion of its rental value as would suffice to pay the rent of a moderate dwelling, the excess of the annual value of such homestead above the sum might with justice be taxed. An allowance of three or four hundred dollars might not be unreasonable; and to the same amount the deduction allowed . . . for rent actually paid ought to be fixed, so that owners and renters should enjoy equal privileges under the law."

The same views were held by the Special Revenue Commission of 1865.† This commission recommended that "in

*Act of 1864, section 117.

† House Executive Documents, 1st Session, 39th Congress, No 17, vol. VII. This

assessing the income tax no allowance whatever be made for house rent, or, at least, that the income allowed to be deducted for rental should not in any case be allowed to exceed three hundred dollars. As the law now stands, rentals of an excessive and unreasonable amount are often deducted; and the gain to the revenue in the city of New York alone, from the repeal of that part of the act authorizing the deduction of rentals, would, in the opinion of the revenue officials, amount to over two millions of dollars per annum."

The other deductions expressly allowed by law were as follows: "the amount actually paid for labor or interest by any person who rents land or hires labor to cultivate land, or who conducts any other business from which income is actually derived";* "the amount paid out for ordinary or usual repairs, provided that no deduction shall be made for any amount paid out for new buildings or permanent improvements or betterments made to increase the value of any property or estate";† "the losses actually sustained during the year arising from fires, shipwrecks, or incurred in trade, and debts ascertained to be worthless, but excluding all estimated depreciation of value";‡ the amount of all national, State, and municipal taxes paid within the year; and "losses within the year on sales of real estate purchased two years previous to the year for which income is estimated." §

V.

The administration of the income tax was under the charge of the Commissioner of Internal Revenue, an office created by the act of 1862; and the assessment and collection of the

commission was appointed under the act of March 3, 1865, to consider and report on the revision of the revenue system The members were David A Wells, Stephen Colwell, and S S Hayes

* Act of 1867, section 117 But the same provision in substance was introduced in the act of 1864

† Act of 1867 In the act of 1864 it was "amount paid out for usual or ordinary repairs, not exceeding the average paid out for such purposes for the preceding five years."

‡ Act of 1867.

§ Act of 1867. This clause was not retained in the act of 1870.

tax devolved upon the assessors and collectors of the internal revenue. The income assessed was that for the calendar year. At first the tax was assessed on or before the 1st of May following, and was due on or before June 30; but under the act of 1867 the assessment was made on or before the 1st of March, and the tax was payable on or before the 30th of April, this change applying to the assessment of 1867.*

The penalty for delay in payment was, at first, an addition of 5 per cent. to the amount of the tax remaining unpaid (act of 1862); then 10 per cent. (act of 1864); and later 5 per cent., with interest at 1 per cent. per month until the tax was paid (act of 1867). The penalty was imposed if the tax remained unpaid for thirty days after it became due, and for ten days after notice and demand thereof by the collector. The collection of the tax could be enforced by levying on the property of the delinquent.

The most serious difficulty in the assessment of an income tax is of course to ascertain the income of the tax-payer. In these acts the main reliance was upon the tax-payer's written declaration, verified or corrected by such information as the assessor might have or such investigation as he might lawfully undertake. We follow the provisions of the act of 1867, noting any important points of difference between that and preceding acts: "All persons" were required "to make and render a list or return . . . of the amount of their income, gains, and profits." This return was "to be verified by the oath or affirmation of the party rendering it." † In case any person neglected or refused to make a return or made a fraudulent return, the assessor was to make out the return "according to the best information" he could obtain, "by the examination of such person or his books or accounts or any other evidence." In these cases of refusal or neglect, 50 per cent. was added to the tax due on the list as made out by the assessor. In case of a fraudulent return, 100 per cent. was added. Moreover, under a general provision of the internal revenue laws, any person convicted in the United

*The reasons for the change are stated in the *Report on Finances* for 1864, p. 70.

†The oath was first required under the act of 1864.

States court of making fraudulent returns might be punished by a fine not exceeding $1,000 or by imprisonment not exceeding one year or both (act of 1864, section 15). The assistant assessor might also increase the amount of any list or return, if he had reason to believe that it had been understated. The person who made the return might then "exhibit his books and accounts, and be permitted to declare under oath or affirmation the amount of income liable to be assessed; but such oaths and evidence" were not to be "considered as conclusive of the facts, and no deductions claimed in such cases" were to be allowed "until approved by the assistant assessor." There was an appeal from the decision of the assistant assessor to the assessor, whose "decision thereon, unless reversed by the Commissioner of the Internal Revenue," was to be "final."

During the greater part of the time that the income tax was in force it was the custom to publish the incomes of individual tax-payers in the local newspapers. At first, in accordance with the instructions given by the Commissioner of Internal Revenue, all information in regard to individual returns was withheld from the public. But in the absence of any express legislative prohibition of publicity, and under the pressure of newspaper enterprise, the custom was soon established of publishing full lists of tax-payers and their incomes. In support of this practice it was urged that its effect was to increase the assessment and secure more complete returns. But it is a question whether its advantages in this respect were great enough to offset the annoyance and some injury to which it often subjected the tax-payer, and the odium which was attached to the tax in consequence. The practice gave rise to much dissatisfaction and complaint, but was not abolished until prohibited by the act of 1870.

VI.

By the act of 1864 (section 19) the personal income tax was to be levied until and including the year 1870, and no longer. Under this provision the last income assessed would have been that of 1869. It was an oversight, doubtless, that this limitation did not apply to the tax on interest, dividends, and gov-

ernment salaries; but, as the act was passed, the tax on these forms of income was held to be continuous, remaining in force until repealed by Congress.

As the time for the expiration of the personal income tax drew near, the question as to its renewal or continuation was raised. The revenues of the government so far exceeded expenditures that a considerable reduction of taxation was possible; but many believed that the income tax should be retained until certain other taxes, believed to be more objectionable, had been abolished.* In 1870, a bill "to reduce internal taxes," and expected to secure a total reduction of nearly $34,000,000, was reported to the House by the Committee of Ways and Means.† It continued the income tax indefinitely, retaining the 5 per cent. rate, but raising the exemption to $1,500. This increase in the exemption would, it was estimated, effect a reduction of $5,741,105 in the revenue from this tax. The proposal to continue the income tax met with strong opposition. In both the House and the Senate the question was debated at length. The *Globe* contains a long series of speeches in which the arguments both for and against the tax are urged with tedious repetition. Without attempting to follow the debate, we present some of the arguments advanced on each side of the question.

The counts in the indictment of the income tax, if we may so express it, were substantially as follows:—

1. The income tax was inquisitorial. It was "at war with the right of every man to keep private and regulate his business matters." ‡

2. The assessment in different sections was unequal, and the territorial distribution of the tax unjust. It was pointed out that more than

* "So long as a large internal revenue is required by the financial necessities of the government, a portion of that revenue should be collected from the income tax The reason for this seems apparent and forcible The tax simply reaches the profits of trade and business and the increased wealth of individuals from investments" Report of Commissioner of Internal Revenue, 1869.

† It removed the taxes on successions and legacies, $2,434,593; on gross receipts of railroads, insurance companies, etc., $6,109,617, on sales, except sales of liquor, $8,197,784, on gas, $2,116,005, special taxes, to the amount of $8,197,752, and taxes on carriages, watches, etc.

‡ See some emphatic language by Mr Kelley, of Pennsylvania, *Congressional Globe*, p 3994

half the tax was collected from 20 out of the 235 revenue districts ; that California paid more income tax than the States of Indiana, Iowa, Wisconsin, Kansas, and Nebraska combined ; New Jersey more than this same list of States, with the addition of West Virginia ; that one district in Illinois paid more than all the other thirteen, two districts of Massachusetts about as much as the remaining eight; that Massachusetts, with $5\frac{1}{6}$ per cent. of the total taxable property of the country, paid over $12\frac{1}{2}$ per cent. of the total income tax, and Illinois, with 6 per cent. of the taxable property, paid only $4\frac{1}{2}$ per cent. of the income tax.

3. The tax was unjust because it rested on a small number of citizens. Out of 40,000,000 people, there were only 272,000 who were subject to it.

4. On the other hand, it was said that the tax was oppressive, because it did not fall upon the wealthy few, but was, in the end, paid by laborers and consumers in the form of lower wages and higher prices.

5. The tax was not honestly collected. "Does any one believe," asked one member, "that there are only 9,464 persons with incomes exceeding the sum of $5,000 ? Why, there are that number in New York City alone. Nobody can deny it. Does anybody believe that out of the whole 40,000,000 people in the United States there are only 272,843 who have incomes exceeding $1,000, that only about half that number have incomes not above $1,400 ?"*

6. The tax was "perjury-provoking," — a tax on conscience, offering a premium for dishonesty.

7. It was a "war tax," and to continue it was a breach of "the plighted faith of Congress." The people had been assured by "as solemn a pledge as can be given in a law of Congress" that the tax should expire in 1870.

8. The tax was unconstitutional ; for it was a direct tax, and ought therefore to be apportioned on the basis of population.

9. The income tax laws were inconsistent and unjust in their provisions. The earnings of labor were taxed as severely as income from invested capital.† Again, there was no exemption allowed on incomes consisting of interest and dividends ; and this fact worked injustice to those widows and orphans who were dependent on small incomes of this description.‡

The following were some of the arguments offered in support of the tax : —

1. It was asserted that there "never was so just a tax levied as the income tax." It was "an assessment upon every man according to his

*Remarks of Mr. Sargent, of California, in *Congressional Globe*, p 4029.

† See remarks of Mr. Garfield, in *Congressional Globe*, p. 4036

‡ "This tax is not levied alone on those who have more than $1,000 per annum I know those who have not $300 a year who pay an income tax, many of whom are

ability to pay,—according to his annual gains." * It was the only tax in our system which regarded differences of wealth,—"the only tax which makes any distinction between John Jacob Astor and the poorest drayman in the streets."†

2. It was "about the only tax which reaches to any extent the large amount of personal property in this country"; for "personal property escapes taxation in the States almost entirely."‡

3. It was true that the tax was levied on a small number of people But they were the ones who did not contribute their share of other taxes, of taxes on consumption. Said Senator Sherman, "If you leave your system of taxation to rest solely upon consumption, without any tax upon property or income, you do make an unequal and unjust system."

4. The income tax was a means, and probably the only means, of assessing the bondholders. The United States bonds were "exempt from all taxes except such income tax as may be levied by the United States upon all income," the only tax that rests on this class of property, amounting in this country now to more than $1,000,000,000." §

5. If there had been a good deal of opposition to the income tax, it did not come from the people as a whole; for the great body of the people were not reached by it in any way. The clamor for the abolition of the tax was a "local and manufactured cry." It represented "a special interest." ‖

widows and orphans. I mean those who have a small amount invested in bank and other stock" Remarks of Mr. Archer, in the *Congressional Globe*, p. 4033

* Remarks of Senator Sherman, *Globe*, p 4714 Senator Sherman was one of the ablest supporters of the tax, and but for him the Senate would probably have thrown out the sections continuing the tax altogether Most of the arguments given here are found in his remarks, and the language quoted is generally his Some of the extracts are taken from a speech delivered by him in the next session, when the income tax question was again under consideration This speech is printed in the Appendix to the *Globe*,—41st Congress, 3d Session,—and has been published in his *Collected Speeches*

† Mr Blair, of Michigan, *Globe*, p 3993

‡ Mr Ward, of New York, *Globe*, p 4027.

§ Senator Sherman, *Globe*, p 4716

‖ "We all know how liable we are to be controlled by special interests, to the exclusion of the great mass of the people Special interests besiege our committee rooms, and besiege us as we come to our seats daily, follow us to our rooms and press their special claims upon us." Mr. Ward, of New York, *Globe*, p. 4027 "The possession of large property and the ability to earn large income necessarily gives to those enjoying that income great influence over public opinion They speak through the daily press, from high official stations, from great corporations, from cities where wealth accumulates, and with all the advantage of social, personal, and delegated influence. I know the power of this influence" Senator Sherman, *Ibid*

6. The income tax was not more inquisitorial than many other features of the internal revenue system, or than personal property taxes in the States. Exceptional cases of hardship and injustice would exist under every tax law

7. The tax might be the occasion of false statements and perjury, but the fact that rich men commit perjury to avoid the payment of the tax was no reason for excusing them from the payment of it altogether.*

8. The abolition of the income tax was a part of the policy of the protectionists, who "earnestly favor reduction in this and all internal taxes, in order to create a necessity for their onerous and unjust system." †

9. The revenue from the income tax was needed It could not be abolished unless other taxes far more objectionable and oppressive were to be retained.

It was not expected, probably, that the weight of any of these arguments on the merits of the question would seriously affect the result. At any rate, an analysis of the vote leads to the conclusion that the proportion of the tax paid by a particular section of country was usually the dominant consideration with members from that section. The division was not on party lines, although it so happens that in the Senate all the Democrats went on record against the tax; but so, too, did many of the Republicans.

The House voted by a strong majority to retain the tax, having first reduced the rate to 3 per cent. and raised the exemption to $2,000. The Senate was more evenly divided on this question; and there the income tax sections of the bill underwent many vicissitudes of fortune before their fate was finally decided. The Committee of Finance, of which Mr. Sherman was chairman, reported these sections in the form adopted by the House. The opposition in the Senate was immediately made manifest. Mr. Conkling wanted to take a vote at once on striking out the income tax. Mr. Sherman reminded the Senate that, if that tax was stricken out, they would have to restore some other taxes which it was proposed by this bill to repeal. It was, he insisted, simply "an alternative between this and some other form of tax." After some debate the vote was taken, and the income tax was stricken

* Mr Blair, of Michigan, *Globe*, p. 3993

† Mr Wilson, of Minnesota, *Globe*, p 4023.

out by a vote of 34 to 23. This threatened a reduction in the revenue of $17,700,000, which, with the reduction of $74,000,000 already provided for in the bill, would, Mr. Sherman declared, result in a deficit. How should this deficit be made good? There were senators who expressed themselves in favor of retaining the existing taxes on tea, coffee, and sugar, which, as the bill then stood, were to be reduced; others thought it was possible to abolish the income tax, and still make all the other proposed reductions; and, finally, the question was referred to the Committee of Finance for reconsideration.

In behalf of the committee Mr. Sherman reported that they accepted the decision of the Senate in regard to the income tax as final, and would make no further effort to continue it; but, to offset the loss of revenue, they proposed to restore the existing duties on sugar and the tax on gross receipts. The Senate was not disposed to sustain the committee in this action, and voted at first to make the proposed reductions in the sugar duties and abolish the tax on gross receipts; but, on reconsideration, this decision was reversed as regards the sugar duties.

These votes had all been taken in Committee of the Whole. When the Senate, sitting in ordinary session, came to review the bill, one or two senators who had voted against the income tax declared themselves now convinced of the necessity of retaining it; and before the main question was put Senator Wilson, with the intention, probably, of making the measure more acceptable, moved to reduce the rate to 2½ per cent. and limit the duration of the tax to two years. But this motion was voted down, and the Senate then concurred in the action of the Committee of the Whole striking out the income tax. This was the second vote on the question, and stood 26 to 22. Mr. Sherman now moved to restore the tax on gross receipts. He did not believe that "there were many taxes in the tax list worse than the tax on gross receipts. But," he said, "we cannot repeal all the taxes proposed to be repealed." The motion was lost by a tie vote, 25 to 25. The result of this vote seems to have turned the tide in favor of the income tax. Two or three senators had voted against the income tax with the expectation that the tax on gross receipts would be restored;

but, since the Senate had voted to dispense with the latter tax, it was necessary, they believed, to restore the former. A motion was accordingly made to reconsider, and was carried by a vote of 26 to 25. Mr. Wilson again offered the amendment mentioned above, which was now accepted; and the income tax sections thus amended were restored to the bill by a vote of 26 to 22,— the third vote on the tax. Even then the enemies of the tax rallied their forces, and all but succeeded in carrying their point. They managed after a good deal of parliamentary manœuvring to bring up the question again on a motion to strike out. The motion was lost, but only by a tie vote, 26 to 26,— this being the fourth vote on the income tax.

The friends of the tax had won after a hard struggle, but it was a rather barren victory. The rate had been reduced to $2\frac{1}{2}$ per cent., the exemption raised to $2,000, and the tax, thus curtailed, was to expire in two years. In the following sessions of Congress no one seems to have had the hardihood to propose to prolong its existence beyond that period.

The enemies of the tax, however, thought it worth their while to attempt to deprive it of even this short lease of life. In the next session of Congress a bill repealing the income tax sections of the recent act was introduced in the Senate, debated at some length, passed by a vote of 26 to 25, and sent to the House. The House at once returned it with the respectful suggestion that the Constitution vested in the House of Representatives the sole power to originate such measures. A similar bill, however, had been introduced in the House by one of its own members, and was easily defeated by a strong majority.

The influence of sectional interests, to which we have referred, is well illustrated by this last vote of the House; for it was taken after the question had been thoroughly discussed on the floors of Congress and by the press throughout the country. Members had had ample time to consider the question, and learn the wishes of their constituents. The vote stood 117 in favor of the tax to 91 against it. The States of California, Connecticut, Massachusetts, New York, New Jersey, Maryland, Pennsylvania, and Rhode Island, which, taken together, contributed about 70 per cent. of the total income tax,

cast 61 votes against the tax, and only 14 in favor of it. The States of Alabama, Arkansas, Indiana, Iowa, Michigan, Nebraska, Mississippi, Missouri, New Hampshire, North Carolina, Tennessee, Texas, Virginia, West Virginia, and Wisconsin, which together contributed less than 11 per cent. of the tax, cast 69 votes in favor of the tax, and only 5 against it. Of the 91 votes against the tax, about 53 represented districts contributing more than $100,000 each. About 21 represented districts contributing less than $50,000 each. Of the 117 votes in favor of the tax, only 9 represented districts contributing over $100,000 of tax; while more than 80 represented districts contributing less than $50,000.

A word must be added as to the disposition made of the tax on interest, dividends, and United States salaries under the act of 1870. When the question was under discussion in the Senate, it was pointed out that practically this tax had gone into operation seven months later than the tax on personal income. Both taxes had been introduced under the act of July 2, 1862. But it must be borne in mind that the one was assessed annually on the personal income of the previous calendar year, while the other was assessed as the dividends, interest, or salaries subject to it were paid or became due. As the act went into force August 1, income consisting of dividends, etc., was taxed only from that date; but the first assessment of the personal income tax in 1863 covered the entire calendar year 1862. In order, therefore, to equalize the duration of these two taxes, the Senate voted to continue the tax on dividends, interest, etc., until August 1, 1870. This vote was passed under the assumption that the personal income tax was to end in 1870, with the assessment of the income of 1869. But it was afterwards decided, as we know, to continue this tax two years longer at a lower rate; and an attempt was made to provide for a similar extension of the tax on dividends. But, after the act had been passed, it was found to provide that the tax on dividends, interest, and government salaries should be assessed only "during the year 1871." The result was that the 5 per cent. tax on this form of income terminated, as had been intended, August 1, 1870; but the 2½ per cent. tax did not begin until January 1, 1871,

and then lasted only one year, while the 2½ per cent. tax on personal income was assessed two years, covering the income of 1870 and 1871.

VII.

It is to be regretted that we have not more complete statistics and fuller information in regard to the assessment of the income tax. The annual reports of the Commissioner of Internal Revenue give in detail the amount of tax collected in each State and district; but they do not, as a rule, give the amount assessed, even for the entire country, and they contain no statements whatever of the amount of income returned for assessment.

We have, however, estimated as well as we could from the available data the amount of taxable income returned in different years; *i.e.*, the amount of income exclusive of exemptions and deductions. Most of these estimates are based upon the annual collections. They are approximations only; but they must come near enough to the actual returns to show the direction, and roughly the extent of the variations from year to year.*

From the amount of tax collected in 1864 we conclude that the amount of taxable income returned in 1863 could not have been far from $400,000,000. In 1864 it must have been about $500,000,000, and in 1865 about $850,000,000. This remarkable increase may have been in some measure the result of greater efficiency and more experience in the administration of the tax; but it must have been mainly due to an actual increase in money incomes caused by the inflation of the currency.

In 1866 there was a marked falling off in the returns. The aggregate of taxable income for that year was about $706,000,000. The upward movement of prices came to an end in 1865; and this circumstance must have had an unfavorable effect on the nominal, if not the real, profits of many forms of business enterprise. It may well be, then, that there was, in fact, less income to be assessed in 1886 than there had been

*For our results and the explanation of the method by which we obtained them see Table II., Appendix, p 492.

the year before. At the same time it is probable that the tendency to evade the tax and make incomplete returns of income was becoming stronger and more generally operative. It could hardly fail to be stimulated by the very high rates introduced under the act of 1865. These rates had the effect, in most cases, of more than doubling the tax to which the same income had been previously subject.* We can readily believe that many persons who stood up squarely to be taxed on their full incomes, while the rate was not above 5 per cent., might resort to some device to evade in part, at least, the burdens which the act of 1865 imposed. It is not difficult to understand why this effect of raising the rates would not be apparent in the first assessment under the act in 1865; for it would naturally be concealed and more than counteracted until the upward movement of prices came to an end.

It may be, too, that the returns of 1866, as compared with those of 1865, show the influence of the war spirit upon the productiveness of the tax. The assessment of 1865 was made just as the war had been brought to a successful termination. The North was rejoicing in the triumph of victory; and there was no period, probably, when the burden of war taxation was more cheerfully met. After a year of peace the people began to feel that such high taxes were no longer necessary. To take one-tenth of a man's income in addition to all the other taxes he was required to pay may then have seemed like an unjustifiable confiscation of property.

After the act of 1867 went into force, a considerable reduction of taxable income would of course result from raising the exemption from $600 to $1,000. But the probability is that the falling off which actually took place was somewhat greater than can be accounted for in this way. The amount of taxable income returned in 1867 was about $548,000,000, which shows a reduction of about $158,000,000 below the returns of 1866.† The amount of income assessed in 1868

*The effect, for instance, on an income of $10,000 would be to raise the tax from $282 to $720 The increase in rates was most marked upon that portion of income between $5,000 and $10,000. Here the rate rose from 3 per cent. to 10 per cent.

†The number of persons assessed in 1867 was 266,135. For each of these the higher exemption would make a reduction of $400 in taxable income That

was about $467,000,000. In 1869 and 1870 the assessments averaged about $519,000,000, so that, on the whole, there was but a slight reduction while the act of 1867 was in force,—hardly as much as we should have expected in a period of falling prices.

The act of 1870 raised the exemption to $2,000. This of itself would make another large reduction in the returns of taxable income. But here again, as in 1867, the amount actually returned — about $320,000,000 — shows a reduction greater than the higher exemption would explain, so that other causes must have been operative. The best evidence of this is found in a comparison of the number of persons taxed before and after the act went into operation. In the last assessment, previous to the passage of the act the number of persons returning incomes over $2,000 was 94,887; but in the next assessment the number fell off to 74,775. (See Table III.)* In other words, nearly 20,000 incomes besides those excluded by the higher exemption disappeared from the assessment rolls after 1870.†

It will be found, too, that the incomes over $2,800 returned after 1870 were not so many as those over $3,000 had been before, and that the incomes between $2,800 and $12,000 were not so many as those between $3,000 and $11,000 had been in previous returns.‡

would account for $106,000,000 of the total reduction There would also be the loss caused by the entire exemption of all incomes between $600 and $1,000 We find that in 1867 the number of persons assessed was less by 194,035 than it had been in 1866 If those who thus disappeared from the assessment rolls had on the average an income of $866, the total reduction would be fully explained, but $866 is rather too high to represent the average of incomes between $600 and $1,000 The inference is that there must have been some loss of income besides that which legitimately resulted from raising the exemption, but, if we may assume that the average for incomes between $600 and $1,000 was not over $800 nor under $700, we are justified in concluding that the amount of reduction not covered by the higher exemption could hardly have exceeded $25,000,000, and may have been as low as $15,000,000

* Appendix, p 494.

† Many of these incomes may not have been much above the limit, and may have escaped taxation simply because the tax had been so reduced that the assessors could not afford to take any great pains to secure it For instance, an income of $2,100, which had previously been subject to a tax of $55, would now, if assessed, contribute only $2 50.

‡ It is not possible to ascertain from the published statistics exactly how much of the reduction in taxable income, under the act of 1870, remains unex-

We find, then, that the returns of taxable income fell off from $850,000,000 in 1865 to $320,000,000 in 1871 and 1872, and that, while a portion of this reduction was the result of raising the exemption, a considerable amount must have been due to other causes. It is noticeable, too, that the reduction was not constant or uniformly distributed throughout the period, but took place principally in the years 1866, 1867, and 1870. In 1866 there was a reduction of nearly $150,000,000 without any change in the exemption. In 1867 there was a further reduction of about $160,000,000, partially explained by a higher exemption; and in 1870 another reduction of $220,000,000, again partially explained by a higher exemption.

The statistics at our disposal appear to justify the inference that from $290,000,000 to $330,000,000 of the total reduction in this period was the legitimate result of raising the exemption, and that from $200,000,000 to $240,000,000 must be explained by an actual reduction of incomes, by increasing evasion of the tax, or by both of these causes. The period was one of falling prices, which would of course tend to produce a reduction of income. At the same time the tax was becoming more and more unpopular,—at least among those who were required to pay it. As a war tax, it had been accepted with comparative cheerfulness; but, under the prospect that it might become a permanent peace burden, the tax-payers became uneasy. This feeling was naturally intensified by the renewal of the tax in 1870, after the limit set to its duration in previous legislation had expired. Raising the exemption to $2,000 did not, probably, make the tax any more acceptable to those whose incomes were still subject to it. Whether with good reason or not, they regarded the high exemption as an unjustifiable discrimination which savored of class legislation. All this would make the tax-payers more ready to compromise with conscience when called upon to state their incomes. Furthermore, the disposition to evade the tax may have been rendered more effective by the changes in the direction of leni-

plained by the higher exemption; but, if we may assume that the average of incomes between $1,000 and $2,000 was not less than $1,400 nor more than $1,500, it is safe to conclude that the unexplained reduction must have been between $35,000,000 and $50,000,000

ency which, under the act of 1870, were introduced in the method of assessment. It had previously been the practice, as has been stated, to publish the returns of income in the local newspapers; and the law had required declarations from all persons of lawful age. It is not to be supposed that this requirement was enforced to the letter; but it gave the assessors the right to demand a declaration from all such persons. Under the act of 1870, however, the declaration could only be required of those whose incomes exceeded $2,000; and the publication of individual incomes was forbidden. These changes were doubtless concessions to the feeling against the tax, and may have rendered evasion easier.

Reference has already been made to the exceptional character of the assessment of 1868. If we compare the number of persons assessed while the act of 1867 was in force, we can hardly fail to notice further indications of abnormal disturbances in that assessment. (See Table III.) The period, as a whole, shows a slow increase in the number taxed;* but in 1868 the number is less by 11,500 than in the year before, and less by 22,000 than in the year after. The effect is seen in the amount of tax assessed, which is less by $4,000,000 than it had been the year before. The corresponding difference in the returns of taxable income was $80,000,000.

This was the last assessment under President Johnson's administration, and in all probability simply indicates the bad results of changes made in the list of assessors and collectors. There are some interesting remarks and statistics bearing on this point in the reports of Commissioner Rollins. The following extract is from the Internal Revenue Report for 1867: p. "The number of changes which have occurred during the last fiscal year in the *personnel* of the service exceeds that of any year preceding, and, so far as relates to assessors and collectors, may be conveniently presented in tabular form:—

*This increase is confined mainly to the lowest class. If we leave the year 1868 out of consideration, the figures for the other classes are remarkably uniform. The decrease in 1868 shows itself to some extent in all classes except the fourth In that, rather strangely, the number is considerably higher than for any other year. See Table III., Appendix, p 494.

No. of changes in each office.	Collectors.		Assessors	
	No of districts in which changes occur	No of persons discharging duties of office at different times during the year	No of districts	No of persons discharging duties, etc.
1	38	76	32	64
2	14	42	32	96
3	60	240	50	200
4	1	5	2	10
5	1	6	—	—
	114	369	116	370

Thus it will be seen that in 114 districts 369 persons served as collectors, and in 116 districts 370 persons discharged the duties of assessors. The great number of changes in several of the districts arose from the rejection by the Senate of the nominees of the President." Again, in the Report for 1868 (p. xviii), the Commissioner speaks of "the antagonism between the legislative and executive departments which has so sadly damaged the service of the past two years." The new men thus introduced into office were inexperienced, if not otherwise incompetent; and they must have made this assessment with the consciousness that in all probability they would not be retained in office long enough to make another.

VIII.

The chief requisites of a tax in time of war are productiveness and promptness. A war tax must, first of all, be such that, notwithstanding the disturbed industrial conditions which may prevail, it will yield a considerable revenue very soon after its adoption. The questions of justice in its distribution or incidence, and of freedom from vexatious features in its assessment, cannot be ignored; but their presence

is not felt as in times of peace, when the system of taxation is expected to be more or less permanent.

The tax on incomes was one of the most productive of our war taxes. During the ten years that it was assessed it yielded $376,000,000, which was more than one-fifth of the total internal revenue for that period. In 1865 nearly 29 per cent. of the internal revenue was derived from this source. In the matter of promptness the record is not so favorable. The internal revenue system went into operation September 1, 1862. The tax on dividends, interest, and salaries began to bring in revenue at once; but the amount was small, and only $2,000,000 had been collected from this source up to July, 1863. Under the 5 per cent. rate imposed by the act of 1864 this tax yielded from $8,000,000 to $9,000,000 annually. The returns from the personal income tax did not begin to come in until about July 1, 1863. But nearly all of the first assessment, amounting to about $14,000,000, must have been collected before December 1, 1863. Up to that date the total collections of internal revenue amounted to nearly $75,000,000. It is safe to say that at least one-fourth of this amount consisted of the two forms of income tax.

That these sources of revenue were not more promptly productive was not the result of difficulties inherent in the nature of an income tax. The delay was, to a large extent, needless. It was doubtless due, in part, to the entire novelty of this form of taxation in the United States, and in part to the somewhat timid and dilatory policy of the Secretary of the Treasury. If the income tax provided for in the act of 1861 had been assessed, it would have brought into the treasury before December, 1862, something like $8,000,000 or $9,000,000,—not a large sum, to be sure, but it would have come in at a time when revenue was sorely needed. Moreover, when the tax went into operation under the act of July, 1862, the dates fixed upon for its assessment and collection were needlessly remote. There was no apparent necessity for waiting until April 30, 1863, before making the assessment, and until June 30 before beginning with the collection.

Such delay would doubtless be avoided if similar conditions of urgency should ever prevail again. An income tax could

be assessed on the income of the year preceding its enactment without more delay than is required for organizing and setting in operation the machinery of assessment. With an internal revenue office already in existence, the time needed for this could hardly exceed a few weeks.

An income tax has the considerable advantage of being responsive to the influences of patriotism, which are certain to be strong whenever a serious war is undertaken by a democratic country. Indirect taxes have not this quality. Their returns depend on the course of trade, industry, and commerce, or on consumption, and are likely to be adversely affected by the outbreak of war. But the productiveness of an income tax depends, in large measure, upon the readiness of men to reveal their incomes and meet the tax. To this extent it assumes the nature of a voluntary contribution, to which men will respond more freely when they realize that the hour is one of sore need and, perhaps, of peril to the country. Otherwise it would have taken a stronger government than ours and a more efficient civil service to secure as good results as were obtained from this form of taxation. On the floor of Congress Mr. Morrill referred to "our income tax" as being, "after all, but little more than each individual chooses to pay on his own estimate of his income"; and at another time he said that "the law left it almost to the conscience of each man how much he should pay, and all seemed to vie with each other as to who should pay the most." Doubtless this picture, although rose-colored, had a background of substantial truth. No one seriously imagines that under the war tax all income was fully revealed and adequately assessed; but it is certain that better results were secured from the tax, and with less complaint and opposition than would be possible in ordinary times. It would have been strange, indeed, if the patriotism which led men to volunteer for the field in such numbers had been inoperative when contributions of money were called for.

Our experience with the war tax, however, will hardly explain or justify the movement in favor of a personal income tax of the form now proposed and under the present conditions. Neither does it afford a fair indication of what results

may be expected from such a form of taxation now. We may safely predict that they will compare unfavorably with those which were obtained in the war period unless the assessment is made much more stringent and efficient. Probably, however, the assessment of the war tax went as far in the direction of stringency, and attained as high a degree of efficiency as the temper and disposition of the American people and the condition of our civil service will permit.

A tax on the interest and dividends of corporations presents a different aspect. So far as its assessment is concerned, it is free from the difficulties which beset the personal tax. It may be assessed with comparative completeness and without inquisitorial procedure, and affords a much more convenient and less vexatious method of raising revenue. But it greatly increases the difficulty of making exemptions or reductions out of regard to the circumstances of the tax-payers, and it reaches only one form of income. Justice requires the taxation of other forms also; and this it is difficult to do without a resort to the personal tax.

JOSEPH A. HILL.